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IMPROVING THE HOUSE TELECOMMUNICATIONS PLAN (H.R. 1555)

(Updating *Issue Bulletin* No. 209, "A Report Card on the Pressler Telecommunications Plan (S. 652)," May 5, 1995.)

INTRODUCTION

Following the recent Senate passage of S. 652, the Telecommunications Competition and Deregulation Act of 1995, the House of Representatives is ready to act on companion legislation, H.R. 1555, the Communications Act of 1995. The chief sponsors of this legislation are Representatives Thomas Bliley (R-VA), John Dingell (D-MI), and Jack Fields (R-TX). Unfortunately, like the Senate bill, the House bill fails to take the many important steps needed to deregulate, completely and comprehensively, all aspects of this industry. Worse yet, the House bill actually adds new regulatory powers to an already bloated federal bureaucracy. If Congress hopes to produce landmark deregulatory telecommunications legislation this year, the House must make important changes in the bill.

WHAT'S RIGHT AND WRONG WITH THE BILL

Although H.R. 1555 does include some positive incremental improvements in current law, it needs to go much further to achieve real reform. The bill takes important steps toward liberalizing the telecommunications market. For example, like its Senate counterpart, H.R. 1555:

- ✓ **Eliminates** many important barriers to industry-wide competition in both voice and video markets,
- ✓ **Provides** incentives to open the traditionally uncompetitive local market to competition,
- ✓ **Eliminates** elements of the 1992 Cable Act, and
- ✓ **Somewhat liberalizes** broadcast ownership restrictions.

However, the legislation also is riddled with unnecessary regulation and new mandates. For instance, the bill purports to establish a framework to minimize bureaucracy and regulation, yet contains well over 100 new rule-making provisions for the Federal Communications Commission alone. According to FCC Chairman Reed Hundt, the agency "will need substantial resources" to implement the legislation. "We'll need economists, statisticians, and business school graduates."[1] Testifying at a June 19 House hearing, Hundt noted the agency would need a substantial increase in funding next year because passage of the legislation would put the agency "on the verge of a prodigiously detailed undertaking."[2]

1 Kim McAvoy, "Washington Watch," *Broadcast and Cable*, May 15, 1995, p. 53.

This beefed-up activity may be the type of "deregulation" that FCC bureaucrats like, but it is very different from what most industry experts and consumers would view as true deregulation.

Among its disturbing regulatory provisions, H.R. 1555:

✗ **Establishes excessive entry tests for Baby Bell companies seeking to enter long-distance markets.** Before removing outdated restrictions on Baby Bell entrance into the long-distance market, H.R. 1555 requires the companies to meet a series of standards to prove their local market is open to competition. Yet, the bill contains a perverse incentive that makes meeting these standards very difficult.

Before the Bells are deregulated, they must prove they face regional "facilities-based competitors" that offer comparable network service to both business and residential customers. However, they also must prove they are providing access to their own networks at "economically feasible rates" to allow competitors to resale service through the Bell infrastructure. This would create a perverse incentive, because competitors are unlikely to build a competing network if they can resale off the Bells' network at low rates. Competitors will find it more profitable to resale instead of building the competing infrastructure that needs to be present for the Bells to pass the "facilities-based" test. Consequently, Bell entry into long distance may be delayed for some time.

Another bill passed by the House Judiciary Committee could further complicate this process if it is included in H.R. 1555. The Antitrust Consent Decree Reform Act of 1995 (H.R. 1528), sponsored by Representative Henry Hyde (R-IL), would add a role for the Department of Justice (DOJ) in determining whether a Bell should be granted access to the long-distance market. Basically, the DOJ could deny Bells access to that market if it found there was a "dangerous probability" they could monopolize another market. Combined with the excessively bureaucratic test already contained in H.R. 1555, this would place almost insurmountable obstacles on the path to operating freedom. Furthermore, consumers would be denied access to new competitors and their services.

✗ **Requires that a separate subsidiary be established each time a telephone company wants to enter a new line of business.** Before a Baby Bell can enter long-distance, video services, or electronic publishing markets, it must establish an entirely separate entity to deliver that service. This means unnecessary duplication of facilities and staff, higher operating costs, and lower overall efficiency. The Bells should be allowed to enter a new line of business in any manner they find efficient and profitable, just as any other business can.

✗ **Fails to eliminate barriers to international investment.** Although an amendment to H.R. 1555 allows some opening of the American market to foreign investment, such beneficial activity still would be delayed while the executive branch determined whether it was warranted. This would give provide American firms time to delay the liberalization process to discourage additional competition. Outright repeal would ensure a steady increase in the flow of capital to the American telecommunications market and a subsequent increase in job opportunities, just as free trade has accomplished in such other areas as computers and automobiles.

✗ **Expands telecommunications entitlements.** Like its Senate counterpart, H.R. 1555 expands uncompetitive and ineffective subsidies that flow to corporations instead of to individuals. The bill contains broad, open-ended mandates for the FCC and the states to design and deliver a more extensive package of communications services to all Americans, in part by manipulating the rates consumers pay for those services.

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2 *Statement of Reed Hundt Before the House Commerce Committee Subcommittee on Telecommunications and Finance*, June 19, 1995.

For example, subsidies generally flow from long-distance to local users, business to residential users, and urban to rural users. These overlapping cross-subsidies have destroyed industry competition by discouraging market entry, since few potential competitors have the capital necessary to take on the subsidized firms.[3] By artificially elevating prices in the long-distance market, these subsidies have cost society between $1.5 billion and $10 billion per year in higher prices.[4] Because the House plan preserves and expands many of these mechanisms, it distorts market competition and fails to ensure access to more innovative and truly price-competitive services.[5]

✗ **Fails to move toward complete privatization of the radio spectrum.** By missing another chance to denationalize the government-owned national resource of radio spectrum, the bill fails to open the wireless world to even more vigorous competition. Although making some minor modifications in FCC licensing authority and relaxing some ownership restrictions, H.R. 1555 makes no effort to create property rights in spectrum ownership or to allow holders of spectrum the flexibility to use their spectrum as they choose. Spectrum holders now can use their allocation only for purposes defined by the FCC. For example, the holder of a television station spectrum license may not convert that station into a cellular telephone system even if it would be more efficient and profitable to do so. H.R. 1555 does nothing to rectify this inefficient policy.

✗ **Makes no serious attempt to minimize bureaucracy.** Instead of taking the opportunity to eliminate entire branches and bureaus of the FCC, the bill will lead instead to an increase in the size and power of the federal bureaucracy overseeing the communications industry. The FCC will be responsible for the administration of numerous new transitional rules and regulations. This will prevent deregulation from proceeding rapidly, because the agency works against market liberalization.[6]

In addition to these many flaws, the bill fails to remove all rate and price regulation; fails to lift unnecessary licensing and tariffing requirements;[7] fails to allow utilities into telecommunications markets they currently are prohibited from entering; fails to define what it means to regulate "in the public interest" even

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3 For more information, see John Browning, "Universal Service: An Idea Whose Time Is Past," *Wired*, September 1994, pp. 102-105, 152-154; David L. Kaserman and John W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation*, Vol. 11 (Winter 1994), pp. 119-146; David L. Kaserman, John W. Mayo, and Joseph E. Flynn, "Cross-subsidization in Telecommunications: Beyond the Universal Service Fairy Tale," *Journal of Regulatory Economics*, Volume 2 (1990), pp. 231-249; Peter Pitsch, "Disconnect the Universal Subsidy," *The Wall Street Journal*, April 4, 1994, p. A12; MFS Communications Company, Inc., "In the Matter of Inquiry Into Policies and Programs to Assure Universal Telephone Service in a Competitive Market," *Petition of MFS Communications Company, Inc. for a Notice of Inquiry and En Banc Hearing*, Before the Federal Communications Commission, November 1, 1993; Bridger M. Mitchell and Ingo Vogelsang, *Telecommunications Pricing: Theory and Practice* (Cambridge, U.K.: Cambridge University Press, 1991); MCI Communications Corporation, *Defining and Funding Basic Universal Service: A Proposal of MCI Communications Corporation*, July 1994.

4 Kaserman and Mayo, "Cross-Subsidies in Telecommunications," p. 121. Kaserman and Mayo argue these estimates are likely to be too low, since "they do not consider the incalculable losses resulting from the distortion of dynamic market incentives to create and adopt technological advances that make more efficient use of the long-distance network."

5 See Adam D. Thierer, "Universal Service: The Fairy Tale Continues," *The Wall Street Journal*, January 20, 1994, p. A12; Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 1: The Open Access Solution," Heritage Foundation *Talking Points*, December 13, 1994, p. 2; Senator John McCain, "As We Debate Telecommunications Reform, We Must Ask: Who's Paying For What Here?" *Roll Call*, March 13, 1995, p. 27.

6 See Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 5: Is the FCC Worth Its Cost?," Heritage Foundation *Talking Points*, March 22, 1995; Adam D. Thierer, "Congress Should Let FCC R.I.P: Federal Communications Commission Hurts Consumers, Inhibits Innovation," *Human Events*, March 17, 1995, pp. 10-11, 17; Peter Huber, "Abolish the FCC," *Forbes*, February 13, 1995, p. 184; *The Telecom Revolution: An American Opportunity* (Washington, D.C.: Progress and Freedom Foundation, 1995), pp. 8-61.

7 Tariffing requirements can discourage uncompetitive pricing strategies since competitors are able to see rivals' prices

though many important decisions hinge on such a determination;[8] and fails to include any mention of the First Amendment.

The legislative approach being taken by the Senate and House is most appropriately labeled "deregulatory industrial policy." Supporters of deregulatory industrial policy are convinced they can "create" competition in the telecom industry by rigging the rules of the game to achieve desired results. Countless safeguards, transitional rules, and continued protections for certain industry segments remain in the bills, supposedly to create a "fair playing field." True deregulation, on the other hand, would remove the many unnecessary regulations that constrain the industry without adding numerous new rules in the process.

Although creating a more competitive communications market is a desirable goal, it is unlikely the existing regulatory apparatus is up to the task. The FCC and state regulatory commissions have done more to destroy competitive opportunities than to create them. And it is these institutions that will be charged with creating "competition" under the current Senate and House approach. Telecommunications' sister industry—computers—is a good example of how competition can develop without centralized direction, regulation, or subsidy. Market power is constrained by vigorous technological innovation and consumer choice—not by arbitrary bureaucratic edict. This should be the model for telecommunications.

FIVE CHANGES TO MAKE THE BILL TRULY DEREGULATORY

Despite these weaknesses in the bill, proponents argue correctly that it represents an improvement over the status quo. But the House should strengthen the framework established in H.R. 1555 by more completely and effectively deregulating the industry. Five simple changes would accomplish this.

CHANGE #1: Mandatory Forbearance and the "Most Favored Regulation" Clause

The addition of a mandatory forbearance clause would relieve competitive carriers from all regulation and open the market to unconstrained competition. A competitive carrier would be defined as any carrier facing either actual or impending rivalry. In markets where competition is less pervasive, such as the residential telephone market, regulatory constraints would remain in effect until a pre-determined list of requirements like those found in the bill is met. For example, after completing the "checklist" requirements, Baby Bell companies would be considered competitive and therefore eligible for forbearance from regulation.

The addition of mandatory forbearance should include a "most favored regulation" clause similar to the most favored nation (MFN) treatment accorded by global free trade agreements. Countries that are granted MFN treatment can import their goods on identical terms as other countries. In other words, MFN requires non-discriminatory legal treatment in trade.

This same concept can be applied to ensure non-discriminatory regulatory treatment of competing providers and technologies in telecommunications markets. Once a carrier seeks to offer a new service, it can be regulated no more stringently than its least regulated competitor. Such a provision would ensure regulatory parity within telecommunications markets as the lines between existing technologies begin to blur.

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before they take effect. This could encourage them to mimic their actions and begin pricing their services in tandem. Thus, tariffing requirements often encourage cartelistic markets by discouraging firms from initiating surprise price wars that would benefit consumers but hurt their own profit margins. Licensing requirements often discourage or prohibit firms from entering new lines of business based on arbitrary FCC determinations.

8 See Adam D. Thierer, "A Report Card on the Pressler Telecommunications Plan (S. 652)," Heritage Foundation *Issue Bulletin* No. 209, May 5, 1995, pp. 14-15.

CHANGE #2: Mandatory Sunsetting of New Rules After Two to Three Years

A second important change in H.R. 1555 recognizes that while there may be a need for transitional rules, they should be phased out as quickly as possible. Although the bill clearly contains too many transitional rules, some will probably remain. For these, the House should include language sunsetting their applicability after a two- or three-year transition period. Any perceived need for their continued existence will have to be dealt with in subsequent legislation or the rules will become invalid.

CHANGE #3: Devolving Telecommunications Entitlements

This change would create a more sensible method of subsidization by transferring full authority over the definition and delivery of universal service to the states, thereby ensuring a more geographically tailored and state-specific subsidization policy that targeted subsidies more precisely to those who need them most. Because H.R. 1555 could be scored as a tax increase by the Congressional Budget Office, this alternative would address the problems raised by the House approach.

Again, the "most favored regulation" concept would apply to the provision of subsidies to ensure that no company received an unfair advantage over a competitor. By requiring non-discriminatory subsidization, this amendment would discourage states from subsidizing corporations and encourage them to design a means-tested, voucher-like mechanism to deliver assistance directly to individuals instead of through companies.

CHANGE #4: First Amendment Parity for All Media

All media, whether print or electronic, should be accorded the same First Amendment protection under the law. It makes little sense to regulate an on-line service provider of news differently than a daily newspaper. As such technologies converge, it will become difficult, if not impossible, to regulate them under different standards. H.R. 1555 makes no mention of the First Amendment or of how electronic technologies should be regulated. Congress should recognize the importance of placing all technologies on equal regulatory footing by mandating they be granted the same First Amendment protections.[9]

CHANGE #5: Creating a Free Market for Spectrum

Beyond the incremental reforms found in H.R. 1555, lawmakers should free the electromagnetic radio spectrum from its seven-decade-old regulatory constraints. All incumbent holders of spectrum should be granted irrevocable, perpetual property rights in their wireless holdings. Like all other property, spectrum could be used as the owner sees fit, subject to common law standards of trespass and interference. More important, the FCC would be directed to auction off immediately all competing claims for unused spectrum. Finally, to encourage the government to disgorge as much of its current spectrum as possible, federal agencies would be provided with a certain percentage of any revenues raised from the sale of their spectrum. This would encourage government spectrum users to place some of their vast spectrum holdings on the auctioning block to be purchased for more efficient uses. This plan, originally laid out in a recent report by the Progress and Freedom Foundation,[10] would guarantee more efficient deployment and use of wireless communications technologies.

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9 See *ibid.*, p. 15-16; Fred H. Cate, "The First Amendment and the National Information Infrastructure," *Wake Forest Law Review*, Vol. 30, No. 1 (Spring 1995), pp. 1-50; Jonathan W. Emord, *Freedom, Technology, and the First Amendment* (San Francisco, Cal.: Pacific Research Institute, 1991); Lawrence Gasman, *Telecompetition: The Free Market Road to the Information Highway* (Washington, D.C.: Cato Institute, 1994), pp. 141-151; Michael Schrage, "In the Emerging Multimedia Age, The 1st Amendment Must Come First," *The Washington Post*, September 30, 1994, p. B3; Thomas G. Krattenmaker and Lucas A. Powe, *Regulating Broadcast Programming* (Washington, D.C.: AEI Press, 1994).

CONCLUSION

Many supporters of H.R. 1555 argue that adding more radical pro-deregulatory language to the bill decreases the likelihood of final passage. However, it is unlikely that a more principled bill would face any more serious opposition than the current bill.

Proponents of the current telecommunications bill also point out that it represents the first of many efforts at comprehensive deregulation of the telecommunications industry and that additional improvements can be made in subsequent legislation. This is unlikely. On June 19, the House Telecommunications and Finance Subcommittee held a single two-hour hearing to discuss the future of the FCC. No budget cuts were recommended and no substantial changes in the FCC's current structure were proposed—despite earlier public calls by leaders of that committee for a radical downsizing of the agency.

Although spectrum policy could be dealt with in a separate bill, it is unclear why it should be broken out of the current legislation since a competitive wireless sector is essential to a more competitive wireline sector. If Congress waits months or even years to deregulate the wireless sector properly, a truly uneven playing field could result, further wireless technological innovation could be repressed, and local telephone competition could be delayed.

The House must help the Senate fundamentally reform U.S. telecommunications policy. It can do this by removing—immediately and unconditionally—all barriers to entry, scrapping any overly regulatory language remaining in the bill, effectively reforming the universal service subsidy mechanisms as well as wireless spectrum policy, and guaranteeing that First Amendment protections are enforced equally across all media.

If the House misses this final opportunity to remove the bill's excess regulatory baggage and strengthen its market-oriented elements, it is unlikely that Congress will produce a truly deregulatory bill this year.

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10 *The Telecom Revolution: An American Opportunity*, pp. 70-79.